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IN THE

Supreme Court of the United States

OCTOBER TERM, 1980

JAMES G. WATT, SECRETARY OF THE INTERIOR, ET AL.,
Petitioners

v.

ENERGY ACTION EDUCATIONAL FOUNDATION, ET AL.
Respondents

On Petition for a Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

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RESPONDENTS' BRIEF IN OPPOSITION

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RESPONDENTS' BRIEF IN OPPOSITION

This case arises from administrative defiance of the 1978 statutory mandate requiring the Government to conduct a five year experimental program of OCS leasing in order to test new leasing methods designed to achieve greater diversification in lease acquisitions, more oil and gas production, and improved public revenues. By 1978 the system which Interior used exclusively under the 1953 law—cash bonus auction of 16⅔% royalty leases—had yielded little competition for the leases, and the major oil companies who acquired most of the tracts tended to stockpile rather than to develop the properties. Moreover, by 1978 bonus bid leases were yielding the Government minimal returns—only a 23% net share in the oil and gas produced (16⅔% royalty plus only 7% in cash bonuses) compared to the nearly 50% net share which has long been the result for California through the State's offshore leasing by profit share bidding instead of cash bonus bidding.

Cognizant of the defects of DOI's bonus bid leasing, Congress overhauled the OCS statute in 1978 and established a five-year program of experimentation with new leasing systems. The program was intended to compare traditional bonus bid leasing with results under new non-bonus bidding systems, particularly with profit share bidding. When nine months after the 1978 statute's adoption the necessary new bidding regulations were still not forthcoming, this suit was filed by adversely affected consumers and by California offshore oil lands lessors—the State Lands Commission and the City of Long Beach. On plaintiffs' initial injunction demand the Court of Appeals ruled in 1979 that the Government's delay in issuing the new regulations was not yet an abuse of discretion calling for judicial relief. But when another year passed and the Government had not yet even commenced promulgation of profit share bidding or other non-bonus bidding regulations, the Court below ruled on October 30, 1980 that "the day has arrived when the Secretary's continued delay is unreasonable and frustrates the essential purposes of the OCSLA." The Court of Appeals accordingly ordered promulgation of the new regulations; promulgation of the regulations is now in progress pursuant to a District Court consent order, and the regulations are due for final adoption by June.

The Court below also required "good faith experimentation" by DOI with profit share bidding during the remainder of the five-year experimental period, which reached its mid-point on March 18, 1981 but which has yet to include any non-bonus bid leasing at all. We urge hereafter that no reason arises for this Court's review, for the good faith experimentation ruling below properly vindicates multiple national interests which Congress sought to promote by the experimentation program: diversification in federal oil and gas acquisitions, improved production of oil and gas, and better returns to the public from OCS leasing.

COUNTER-STATEMENT

After rulings of this Court in the 1940s had upheld federal ownership of the outer continental shelf, Congress enacted the 1953 Outer Continental Shelf Lands Act and provided therein for alternative means of leasing. One option was the use of cash bonus bidding, by which the highest cash bidder acquires the lease and then pays the Government a fixed royalty representing a portion of the oil and gas he derives from the lease. A second alternative under the statute was leasing to the bidder offering to the Government the highest rate of return (royalty or profit share) on his oil and gas production from the lease, with a fixed cash bonus for award of the lease. It was the Government's exclusive resort since 1953 to cash bonus bid leasing which led to the enactment of the 1978 provisions mandating a five year experimentation program. It is the Government's refusal to heed the Congressional will which led to this litigation and to the ruling below.

1. *Leasing History*

Instead of royalty or profit share bidding, from the beginning in 1953 the Department of Interior chose bonus-bid leasing of OCS property with the same 16⅔% royalty rate previously used in onshore leasing. In opting for bonus bid leasing of OCS properties of uncertain but potentially enormous oil and gas value, DOI favored the preference of the major oil companies.[1] At the same time

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[1] The major oil companies from the first pressed for use of the cash auction system which most advantages them and eliminates most smaller bidders. Thus, the President of Humble Oil testified in 1949 that:

> "[1]leases should be awarded to responsible and qualified bidders upon the basis of the highest bonus payment offered. Rentals and royalties should not be subject to bidding but should be uniform and fixed in all leases . . . Selection of the successful bidder on the basis of the highest bonus payment

DOI rejected the alternative route which had already produced noteworthy benefits for the State of California. Yet, as early as 1948 testimony by Attorney General Tom Clark had pointed to the successful results of California's profit share leasing of its offshore lands and urged its federal emulation (Title to Submerged Lands Beneath Tidal and Navigable Waters: Hearings on S. 1988 and Similar House Bills Before the Senate Committee on the Judiciary and the House Committee on the Judiciary, 80th Cong., 2d Sess. at 685). California has long experienced through use of profit share bidding very high bids, and a net return representing nearly 50% of the lessees' oil and gas production (JA 39-40).[2] By contrast, under the bonus bid leasing which DOI used in some 40 lease sales held between 1953 and 1978, the United States realized only about a 35% net return on oil and gas production from its leases before the 1970s, and leases awarded since 1972 are yielding substantially less than 30%—in recent years' sales as low as 23% (JA 207; Appendix B to Plaintiffs' District Court Reply Memorandum of July 14, 1980).

The declining federal return from bonus bid leasing chiefly reflects the astronomical rise in oil and gas prices which commenced at the beginning of the 1970s; the price rises have rendered the cash bonuses bid at the front end of the leases increasingly less significant, adding con-

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offered, with rentals and royalties being fixed for all leases, is recommended because that method will assure the higher monetary return to the government as lessor and will secure more responsible operators." Conservation and Control of Submerged Coastal Lands: Hearings on H.R. 5991 and H.R. 5992 Before the House Judiciary Committee, 81st Cong., 1st Sess. at 151 (1949).

In the present case the major oil companies have repeatedly participated below as *amici* in opposition to the plaintiffs.

[2] JA references are to the Appendix in Nos. 79-1768 and 1787 in the court below. See Pet. 4a, n.7.

stantly less to the basic 16⅔% royalty rate.[3] After the oil and gas price rises commenced, Congress was made aware of the defects in the bonus bid leasing system used by DOI, an awareness that ultimately led to the enactment of the key statutory amendments in 1978.

The first manifested flaw of bonus bidding is that only the largest companies have the cash capacity to bid successfully, and they engage in little bidding against each other. In the lease sales held in the years prior to 1972 the average number of bids per tract bid upon was only 3.5 (JA 27), and over 80% of all leases were acquired by the nation's twenty largest crude oil producers (JA 30-31). For instance, in the five years from 1968 to 1972 the twenty majors acquired successively 94%, 100%, 82%, 100% and 77% of the leases sold (*id.*). These results were exacerbated in the 1970s when vast increases commenced in DOI's annual leasing of OCS properties at the same time that oil and gas prices started on their escalating course—a course which has multiplied by tenfold since 1972 the market value of crude oil and natural gas. As a consequence of rising cash bonuses for increasingly valuable federal resources sold in larger annual quantities, competition for leases further declined and major oil company domination was further enhanced. At lease sales held between 1973 and 1978, the average num-

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[3] In 1975 the impact of these price increases on DOI's cash-bonus low royalty leasing system was conceded by Interior Secretary Morton. Testifying before the Congress (JA 53) that the objective of any bidding system must be to "insure receipt of fair market value," he conceded (*id.*) that:

> "[o]n the Outer Continental Shelf, we have been collecting 16-2/3 percent of all of the production. You might say, and I think very well say, this is not a high enough percent because we really don't get true value, if, at the time the bonus is bid, oil is selling at $5 and then it goes up to $10. The 16-2/3 percent royalty is not high enough."

(Hearings on S. Res. 45 and S. Reg. 222 Before the Senate Committee on Interior and the Senate Committee on Commerce, 94th Cong., 1st Sess. at 68).

ber of bids per tract bid upon was only 2.77 and in some sales ranged as low as 1.16 (JA 27-28). Single bidders acquired a substantial portion of the leases awarded with no competition at all (JA 27); in some sales a majority of all the tracts leased were leased to single bidders.

These defects were brought to Congressional attention by a series of five Comptroller General reports issued between 1975 and 1978. They warned that given the restricted competition for DOI's bonus bid leases, there could be no assurance that the Government was recovering fair value—particularly since there was no reliable basis for predicting the actual oil and gas value of any tract.[4] The first Comptroller General report (JA 47-48) noted that increased leasing "will mean increased reliance on bid competition as the only means to insure that fair market value is received for leased resources," and that the eight largest companies were expected to secure most of the acreage as smaller companies could not be expected to bid "because of high risks and costs." The second 1975 report (JA 48) emphasized that "these are the public's resources and it is the Government's job to not give them to industry for less than they are worth," and stated again that the Government "is not doing all that it can do to reasonably insure fair return on the disposi-

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[4] Because of insufficient existing information about likely oil and gas yields, in terms of the expected bonus bid amounts there have been wide discrepancies between the Government's presale estimates of the value of the property and industry evaluations reflected in the high bids actually received. Thus, in lease sales held between May 1968 and the end of 1972, the presale evaluations by the Department of Interior amounted successively to 17%, 26%, 58%, 82% 18%, 14%, 11%, 5%, and 24% of the winning bids; in the first four lease sales of 1973 and 1974 the presale evaluations averaged 22.9%, 9.7%, 29.1% and 17.5% of the winning bids (JA 25). A recent Comptroller General report on a 1979 sale shows no change: the average of the high bids was *20 times greater* than DOI's presale estimates (Some Issues Affecting California OCS Oil and Gas Lease Sale 48, Report of May 5, 1980, at p. 26).

tion of oil and gas shelf resources." A March 1977 report on a lease sale (JA 49) warned again that "estimates of tract values were not reliable and could not reasonably assure that the public received a fair market value return from the leases," and a later 1977 report made similar points (JA 367, 369-71, 401-02). Finally, in a June 1978 report (JA 431) issued just prior to the 1978 statute, the Comptroller General warned again (JA 466) that given the absence of reliable prior evaluation of properties the bonus bid system may encourage industry to "buy very good lands for less than fair market value" and that there was "no assurance that the public received a fair market value return" (JA 463).[5]

It was thus clear by the time the 1978 statutory amendments were adopted that OCS leasing was fostering major oil company domination of federal offshore oil and gas, and that it was questionable whether the Government was receiving a fair return. In addition, it appeared that the same companies were stockpiling their federal oil and gas leases rather than developing them expeditiously (see JA 31-36). It is only these com-

[5] As the GAO explained (JA 463):

"About 60 percent of the tracts in Sale C1 receiving bids got only one or two bids. For Sale 35 and Sale 40 respectively, about 70 percent and 49 percent of the tracts bid on got one or two bids . . . .

The high percentage of one and two bid tracts in Sale C1 is, to us, the primary indicator of inadequate sale competition. As stated in our Sale 35 and Sale 40 reports, a competitive leasing program is based on the premise that competition will provide a fair market value return. When competitive conditions do not exist, however, it becomes increasingly important to have reliable tract values to use as the basis for accepting or rejecting bids. When large percentages of the total tracts in a sale receive one or two bids per tract and are minimally valued based on poor information, there can be no assurance that the public received a fair market value return for the potential resources leased."

panies who have the capacity and incentive to invest substantial cash bonuses in federal leases for future reserves rather than for present return, and the record showed the substantial non-development of their OCS leases (*id.*).[6]

2. *The 1978 Amendments*

The 1978 amendments repeatedly reflect Congressional concern about the multiple defects of bonus bid leasing. Congress provided that leasing "shall be conducted to assure receipt of fair market value for the lands leased and the rights conveyed" (43 U.S.C. § 1344(a)(4)). New provisions were added to assure competition in the industry from OCS leasing (43 U.S.C. § 1337(c)). A "due diligence" requirement was added with respect to exploitation of leases by all lessees (43 U.S.C. § 1351(h)(2)(C)). Finally, Congress provided for an experimental leasing program during a period of five years from the date of enactment (September 18, 1978), to compare the existing leasing system with new leasing systems (43 U.S.C. § 1337(a)(5)). In that respect, the statute identifies three alternative cash bonus bid leasing systems already used before the amendments, including the traditional fixed royalty system, as well as a bonus bidding system for fixed net profit share leases (43 U.S.C. § 1337(a)(1) subsections (A)(C)(D) and (F)). The statute

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[6] Major oil company hoarding has continued to this day. In a DOI release on October 23, 1980, Secretary Andrus stated: "Press accounts of statements by Shell Vice President R.H. Nanz indicate that he is still trying to peddle a myth that there has been a 'lock up' of Federal lands which has slowed development of energy resources. In fact, the foreign-owned Shell Oil Company now owns 44 leases offshore, some for a period of four to five years, on which there has been no drilling or development, and industrywide there are nearly 700 leases offshore on which there has been no drilling. Conservatively, these 700 leases, averaging more than 5,000 acres each, constitute a total of 3.5 million acres not yet drilled." The Secretary concluded that *"Credibility is strained when industry cries out for the leasing of more Federal lands, while at the same time holding millions of acres without any sign of an effort to explore those leases."*

also identifies three non-bonus bid leasing systems (subsections (B) (E) and (G)); among the latter the system which figured most in the legislative process is "fixed cash bonus with the net profit share reserved as the bid variable," the system which California has successfully used for many years. It was the Congressional intent by the experimental leasing program "to assure that adequate information is obtained as to relative advantages and disadvantages of the various bidding systems" (H.R. Rep. No. 95-1474, 95th Cong., 2d Sess. at 92).

The purpose of the experimental program to test non-bonus bid leasing was repeatedly stated in the Congressional reports. Thus, the House Report stated (H.R. Rept. 95-590, 95th Cong., 1st Sess., at 54):

> "The leases have been awarded by auction, traditionally on the basis of cash bonus bids. With the present shortage of investment capital that will prevail for many years, increasing risks of uncertainty, and the increasing integration and concentration of energy industries, there is now doubt whether cash bonus bidding remains the best system for the future. One purpose of H.R. 1614, is to authorize alternative leasing arrangements and require experimentation with them."

Thereafter (at pp. 139-140) the Report explained the new leasing provisions as follows:

> "It was the intention of the Committee that there be a clear mandate given to the Secretary to require him to use bidding systems other than the cash bonus bid. . . . By selecting the 'best tracts' for offering under bonus bid systems, or for offering under non-bonus bid systems, he could limit the ability of some companies to participate in lease sales for these 'best tracts.' To avoid such a possibility, the committee, in paragraph (6) required that, generally, he randomly select those areas to be offered under a bonus bid system and those which would be offered under a nonbonus bid system."

Additional and voluminous legislative history leaves no doubt about the key Congressional intent to mandate experimentation with non-bonus bidding, in the hope of alleviating lease monopolization and stockpiling and of improving federal returns. At the hearings and in the floor debates these themes repeatedly emerged as the focus of Congressional concern (see, e.g., Pet. 33a-34a, n. 70; 42a-44a, ns. 83-89). Thus, the House Report emphasized the testimony that "the high front-end bonuses may have created a barrier to the entry of small and medium-sized oil firms," and that "these types of bids do not, after the completion of exploitation of a lease area, provide a fair return to the Government" (H.R. Rept. 95-590 *supra*, at 138-39). Senator Jackson, a leading proponent of the 1978 amendments, testified that "the net profit-sharing approach offers the greatest or best basis of equity as far as the taxpayers of this country are concerned." Outer Continental Shelf Lands Act Amendments of 1975: Hearings on H.R. 6218 Before the Ad Hoc Select Committee on Outer Continental Shelf, 94th Cong., 1st Sess. at 371 (1975). Noting that large cash bonuses tend to exclude smaller lessees, the Chairman of the Committee of the House which recommended the 1978 amendments expressed the view that "front-end bonus bids are anticompetitive." Outer Continental Shelf Lands Act Amendments of 1977: Hearings Before the Ad Hoc Select Committee on Outer Continental Shelf, 95th Cong., 1st Sess. at 665 (1977).

Particular Congressional interest was manifested in California's profit share bidding system. Representative Miller noted that on some tracts "there would probably be little reason to require a front-end bonus bid; but, rather, one would be interested in having the oil companies bid on the basis of royalty as the City of Long Beach did in California . . ." 124 Cong. Rec. H. 488 (Feb. 1, 1978). The House Committee pointed out that "California has received about 48 percent of total gross revenues from production under so-called 'experimental' lease

terms, as compared to the 16⅔ percent the Federal government will realize from all but three of the Federal OCS tracts leased off Southern California last December" (H.R. Rep. No. 94-1084, 94th Cong., 2d Sess., at 249-250). In the light of those results, the Committee concluded that "There clearly is no reason why the U.S. Government cannot do as well for its people as foreign governments and U.S. States have done for theirs when leasing oil and gas properties" (*id.* at 250).

Finally, no less than the House reports, the Senate report made clear that the new bidding systems "are designed to reduce the front end cash bonus, increase the government's return on actual production of oil or gas, make it easier for smaller companies to enter the OCS development business, and increase the availability of funds for exploration" (S. Rept. 95-284, 95th Cong., 1st Sess., at 46). And the Report emphasized (at p. 73):

> "The basic thrust of all these new options is to reduce the reliance on large front-end cash bonuses as the means of obtaining a fair price for the public's property. The committee wants to authorize lease allocation systems that would encourage the widest possible participation in competitive lease sales consistent with receipt by the public of fair market value for its resources. The committee believes that net profits share and other arrangements can be effective in shifting Government revenue away from initial bonuses and into deferred payments made out of a leaseholder's profits based on actual production of oil or gas." [7]

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[7] The Department of Interior itself has recognized that these objectives are advanced by profit share leasing. As early as 1977 a DOI memorandum (JA 46) concluded that as compared with fixed-royalty leasing, profit sharing "generates more government receipts and simultaneously encourages higher levels of production." In 1978 testimony to the Congress (JA 68), DOI stated that "Under the profit sharing system, the Government takes a share of the profits, after the operator's investments are paid out, whenever oil and gas are produced. This can substantially reduce bonuses, and may thus improve competition."

3. *Violations of the 1978 Law*

At the time of the 1978 amendments there was high anticipation that they would give new life to OCS leasing, for Congress had been assured by the Secretary of Interior that the legislative mandate "will be a positive incentive to doing extensive and detailed background, experimentation, and followup on new bidding systems" (Pet. 33a), and he committed himself "to substantial use of bidding systems other than the cash bonus system" (Pet. 44a, n. 91). But by mid-1979 it had become apparent that even for sake of experimentation the Government was still resisting any leasing other than by bonus-bidding. Instead of promulgating regulations for profit share leasing or any new non-bonus bidding system, DOI continued after 1978 exclusively with bonus bid leasing. True, it tested a system first tried before the 1978 amendments: cash bonus bidding for "sliding scale royalty" leases, which theoretically could provide higher than 16⅔% royalty rates to the Government on very large oil and gas discoveries; but the Comptroller General has found that the DOI scale has been set so high that the royalty is unlikely ever to "slide" above the traditional 16⅔% rate (Report of May 5, 1980, *supra*, p. 6, n. 4, at 40).[8]

Under the continued exclusive use of cash bonus bidding for "sliding scale" or other pre-fixed royalty or profit share leases, *in the eleven OCS lease sales held since the 1978 statutory amendments the number of bids per tract has remained just as low as before, and the major oil companies have continued to acquire almost all the leases.* The average of bids per tract bid upon has remained at 3.0 and in some sales as low as 1.7; the twenty largest producers have acquired 81% of the tracts and in some sales 100% (see Appendix A, *infra*

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[8] DOI has long considered this system only "a variation of bonus bidding" and its leading economist termed it "redundant" for testing purposes. See exhibits 11 and 12 to plaintiffs' District Court Reply Memorandum of July 14, 1980.

p. 1a). Even worse are the results from the recent use of cash bonus bidding for fixed net profit share leases (*id.*).

When it became clear in 1979 that the Government was not testing non-bonus bidding or even issuing the necessary new regulations, this suit was filed by consumer plaintiffs and by California lessors of OCS oil and gas tracts—the State Lands Commission and the City of Long Beach. The consumer plaintiffs asserted that the unlawful failure of the Government to commence testing non-bonus bidding (and particularly profit share bidding), is injuring them by preventing diversification in federal oil and gas acquisitions and by the resulting reduction in the supply of oil and gas because of the stockpiling capacity and incentives of the major oil companies who acquire most of the cash bonus leases (JA 70). In addition, the California plaintiffs alleged competitive injury from the continuing sale of federal oil and gas lands exclusively by cash bonus bidding on terms far more lucrative to lessees than those which the State and Long Beach provide in their offshore leases, with consequent detriment to plaintiffs' leasing capacity and oil production and revenue from their existing leases (JA 71-72).

4. *The Rulings Below*

The first round in the lower courts was won by the Government. Pleading the complexity of problems in issuing new regulations, in late 1979 the Government persuaded the Court of Appeals that it was not yet an abuse of discretion that one year after the new statute's enactment regulations had not issued for the new leasing systems (see Pet. 75a).[9] Warning that the time

[9] The Court did, however, underscore the importance of the new leasing. In its opinion calling for further trial court proceedings (Pet. 96a-97a), the Court noted the conditions which evoked the 1978 provisions (Pet. 78a): "Other developments more directly pointed to inadequacies in the bidding system used in leasing OCS Lands. The dramatic increases in the price of oil and natural gas made it evident that the cash bonus-fixed royalty system of bidding

might come when further delay would constitute abuse (Pet. 97a), the Court of Appeals nevertheless declined to reverse the District Court's denial of a preliminary injunction.[10] But following the Government's judicial victory based on the "complexity" plea, it changed its stance and made clear in 1980 that it had no plans at all to issue regulations for variable net profit bidding or other non-bonus bid leasing. It confessed that no work had been initiated and that "there has been no proposal for a regulation" on profit share bidding (June 1980 deposition of DOI Assistant Director Heintz, p. 111). Thereafter, in opposition to plaintiffs' renewed request for relief the Government asserted in the lower courts that the statute permits DOI to continue exclusively by cash bonus bid leasing even during the five year experimental period. Thus, over two years after the 1978 statute's adoption the Court below found that except for a private contract for an analysis "nothing has been done as to the critical variable net profit share bidding system" (Pet. 19a-20a).

On a renewed motion by plaintiffs for injunctive relief, on September 17, 1980 the District Court declined to resolve the basic issue but on appeal the Court of Ap-

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led to a situation wherein the total royalties paid to the government were declining as a percentage of gross proceeds on wells. Several reports issued by the Comptroller General beginning in 1975 expressed the strong reservation that the cash bonus-fixed royalty system could not assure the government a fair return on its leases. In addition, those reports indicated that the cash bonus system had anticompetitive effects, leaving smaller operations, with fewer financial resources, relatively unable to compete, given the high fronted cash bonus payments and the many uncertainties associated with exploring untested areas."

[10] In its decision, the Court emphasized that Congress, in response to concerns about past leasing, had expressed a clear desire for meaningful experimentation with bidding systems other than the old cash-bonus, 1/6th royalty system. Noting that "Congress was deeply concerned with the assurance of fair market value and adequate competition in OCS leasing" (Pet. 85a), and further noting that Congress was aware of the "substantial evidence to

peals entered an opinion on October 30, 1980 rejecting the Government's position. Based on extensive analysis of the statute and its legislative history, the Court below finds the Congressional interest in non-bonus bid leasing—and particularly profit share bidding—too central to the 1978 amendments to permit the Government to ignore new non-bonus alternatives "without any testing at all" (Pet. 31a). On that score, the Court emphasizes (Pet. 41a) that:

> "Alternatives like the variable net profit share bidding option (and the work commitment bid system) are designed to reduce front end cash payment and to stimulate competition to a greater degree than the options already in place which still focus bidding on the front end cash bonus. Although we obviously cannot determine at this point whether the non-cash bonus variable systems will have the salutory effect in practice that their supporters claim, acquiring this information is precisely the objective of the Congressionally mandated experimentation with new systems."

Focusing specifically on the profit share bidding system which California has long successfully used, the Court concludes (Pet. 44a-46a) that "*we do not think it a reasonable construction of the Act that experimentation with variable net profit share bidding can be rejected.*" Accordingly, the Court has required the issuance of the non-bonus bidding regulations prior to mid-1981, to facilitate "good faith experimentation" with non-cash

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demonstrate the superiority of a profit-sharing bidding system over the cash bonus-fixed royalty option" (Pet. 85a, n. 29), the Court found that "Congress sought experimentation among bidding systems, usually through direct comparisons between cash bonus-fixed royalty bidding and other options, in order to obtain reliable information as to the relative advantages and disadvantages of the enumerated systems" (Pet. at 87a). As the Court stated, "[i]t was hoped that this testing would ultimately enable the Secretary to utilize the system or mix of options which emerged as superior" (Pet. 87a).

bonus alternatives (Pet. 38a) including a "fair test" and "fair trial" of profit share bidding (see Pet. Appendix A at 21a, 47a, 47a, n. 95, 49a).

Since the Court of Appeals ruled, the controversy concerning promulgation of the new regulations has been resolved; on December 19, 1980 the District Court entered a consent order submitted by the parties, under which the regulations for new non-bonus bidding systems are now being published for public comment (see 46 Fed. Reg. No. 43, March 5, 1981, p. 15484) and will be finally adopted by this June. With the regulations issue thus resolved, what remains is the question of DOI's good faith and timely experimentation with the profit share bidding system, as required by the Court of Appeals.

Since half of the five year experimental period has now elapsed, it is crucial that resort to non-bonus bidding commence at once. The eleven lease sales held since September 1978 have all used cash bonus bidding; DOI's promulgated leasing schedule provides for only nineteen more lease sales during the remainder of the five year period, and seven of them are scheduled between May and December of this year. Under these circumstances, the Court of Appeals concluded that any further delay in commencing experimentation with profit share bidding could irrevocably defeat the experimentation program. The opinion below (Pet. 49a) finds "a clear case of irreparable harm to appellants, and the public and private interests they represent," because delay beyond mid-1981 "would mean that experimentation with these options could only occur, if at all, in the last year or two of the five year period, upon whatever tracts remain for exploration. This circumstance would in turn raise a serious question of whether a fair test of variable net profit sharing would be possible, if use of that option were consigned to the last of five years for sales of relatively few and possibly less significant tracts." In sum, if there is not good faith experimentation in the 1981 lease sales with

non-bonus bidding, as required by the Court of Appeals, only 12 lease sales will then remain of the 30 sales scheduled during the entire five-year experimental period. Thus, the Court of Appeals correctly observed that the purpose of the statute's experimental program will be irrevocably defeated unless non-bonus bid leasing commences immediately.

We proceed to a demonstration that the ruling below properly vindicates multiple national interests which Congress has sought to further by experimentation with non-bonus bid leasing of vital public resources. Because the DOI's refusal to heed the Congressional will imperils the fundamental purposes of the statute's experimental program, the Court below has acted properly and no occasion arises for review of its ruling.[11]

REASONS FOR DENYING THE WRIT

There is no issue here presented warranting this Court's review. The primary ruling below requiring issuance of the new regulations has been met pursuant to a consent order entered by the District Court. Moreover, the alleged question concerning plaintiff's standing to sue for relief is entirely insubstantial. Finally, the lower court's requirement of good faith experimentation with non-bonus bidding is eminently correct, vindicating multiple national objectives Congress sought to promote by the five year experimental leasing program.

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[11] The continuing Executive rejection of non-bonus bidding reflects a basic difference with Congress. Whereas cash bonus bid amounts are received by the Treasury immediately, the royalty or net profits receipts on OCS leases typically flow over a period of 10 to 20 years. Thus, Administrations concerned to maximize their annual federal operating funds have favored cash bonus bidding which yields revenues during their term in office. Congress, on the other hand, has taken a longer view in the 1978 statute with an eye to the significant revenue gains expected from non-bonus bid leasing through enhanced ultimate public returns and other national interests.

1. *Regulation Issuance.* The primary question before the lower court was whether the Department of Energy was required to issue regulations for the new non-bonus bid leasing systems identified in the 1978 statute. Finding that the testing of such leasing was the central purpose of the statute's five-year experimental program, the Court below has ordered promulgation of the necessary regulations. The promulgation process is now ongoing, regulations have been published for comment, and will be promulgated finally by June of this year pursuant to a consent order entered by the District Court following the Court of Appeals' decision. The issue concerning regulation issuance is thus finally resolved.

2. *Standing.* In the court below defendants thought so little of their present standing objection that they did not even brief or argue it except as an after-thought by a post-argument submission (see Pet. 51a, n. *). Contrary to defendants' claim, the consumer plaintiffs are clearly injured by the refusal of the Government to promote more competitive leasing, and thus they are entitled to invoke the "citizens' suits" provision of the Act (43 U.S.C. § 1349 (a)). Since monopolization of federal OCS oil and gas leases by the major companies was a chief concern underlying the Congressional mandate to experiment with non-bonus bidding, to vindicate that mandate consumers have at least as much standing as did the consumers involved in this Court's ruling in *Reiter* v. *Sonotone Corp.*, —— U.S. ——; 99 S.Ct. 2326. Moreover, since the major companies who acquire most of the bonus-bid leases have a demonstrated stockpiling incentive and record (see *supra*, pp. 7-8), consumers have additional standing at a time when fuel shortages are a recurring national prospect. Thus, the Court below properly concluded (Pet. 53a) that the statute's grant of standing to parties with a legal interest which "is or may be adversely affected," includes consumers seeking to vindicate provisions "intended by Congress to foster competition and stimulate OCS development."

Moreover, the California governmental plaintiffs have even clearer standing to vindicate the Congressional mandate to test alternatives to the bonus bidding system—a system so favorable to lessees that it threatens California's capacity to lease its offshore properties on favorable terms. As long as the Federal Government continues its exclusive use of bonus bid leasing, which yields to lessees a far greater share than does the California bonus bidding system, there is detriment to the State's ability to lease its own property and to achieve production and profits on its existing leases.

Finally, there is the most immediate injury to California from those OCS lease sales wherein it is forced to be a co-participant in federal leases to prevent the draining away of its own oil and gas on a pool that lies under both the State and the Federal ownership. The statute (43 U.S.C. § 1337(g)(2)) contemplates a revenue division arrangement in such situations, with the state receiving royalties from the federal leases. That was the situation on the very first sale challenged in this suit—Lease Sale 48 held in June of 1979 (see Appendix B, *infra*, p. 2a). In Sale 53 to be held off the California coast this year the same situation again arises (see Appendix C, *infra*, p. 9a), and DOI has proposed to California an agreement providing the State "an interest in a part of the production removed by the Federal lessee" (*infra*, p. 12a). As a participant in the Federal revenues in such situations, California has the most immediate stake in DOI's use of the bidding system which Congress hoped would yield more revenue and under which the State itself has long received better returns. In short, California is losing its own resources under Federal leases let on terms to which the State is bound as a co-participant but which are far less favorable in their returns than those yielded by profit share bidding. Since the States' only protection in drainage situations is to agree to a share of the Federal revenues, it has clearest standing to complain when DOI is unlawfully continuing exclusively with

less-profitable bonus bidding instead of using the system Congress intended should increase returns to the public.

3. *Good Faith Experimentation.* All that could conceivably arise for certiorari review under these circumstances, is the ruling of the court below that good faith DOI experimentation is required with non-bonus bidding, in particular with the net profit system successfully used by California which was at the center of the Congressional interest in experimentation. The Court's ruling (Pet. 44a-46a) that "we do not think it a reasonable construction of the Act that experimentation with variable net profit share bidding can be rejected," is supported by extensive legislative citations leaving no doubt about the correctness of its conclusion. To allow the five-year experimental program to proceed to its end exclusively on the basis of bonus-bid leasing, with no testing of profit-share bidding or any other non-bonus bidding system, is to defeat the central Congressional intention underlying the statute's experimental program. That intent was expressed over and over by the witnesses, by legislators in the floor debates, by the committee chairmen and leading sponsors, and by the House and Senate reports (see *supra*, pp. 9-11).[12] The Congressional will is too plain to permit

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[12] It is noteworthy that even the present Secretary, petitioner herein, has recognized the defects of cash bonus bidding. At a 1975 confirmation hearing Mr. Watt gave the following response to the question on this issue:

> Q. "It has been suggested that substantial new natural gas production is possible from federal lands. However, many smaller independent companies have not been able to engage in the development of oil or gas from federal lands because of the high entry barriers erected by the current system of bonus bidding. Would you favor a revision in existing federal leasing policies to a royalty bidding or some other system in order to permit more than just the largest oil companies to participate in the development of such resources?"
>
> A. *"Yes, I believe we should consider other methods of leasing the Federal lands because the huge front-end payments do*

administrative nullification of a provision characterized by the House report as "*a clear mandate given to the Secretary to require him to use bidding systems other than the cash bonus bid.*" As the Senate emphasized, bidding alternatives which should bring in "more independent producers" are "certainly worth trying on an experimental basis" (S.Rep. 95-284, 95th Cong., 1st Sess. at 47).

The Government nevertheless urges that Congress left "discretion" to the Secretary in his operation of the experimental program. But discretion cannot be given a "plain meaning" which renders meaningless the subject to which it attaches; administrative discretion cannot be so absolute as to nullify the central reason why the experimental program itself was mandated by the statute. DOI's refusal to test any non-bonus bid system at all—and particularly the one in which Congress was the most interested—is an abuse which undercuts the core purpose of the experimentation program and constitutes clear *indiscretion*. As the Court below points out (Pet. 32a-33a), Congress rejected an amendment that would have given the Secretary the absolute discretion he now claims. And as the Court also notes (Pet. 44a, n.91), the 1978 statute was enacted only after repeated Administration assurances that there would be "substantial" resort to non-cash bonus bidding. Indeed, the unlimited discretion claim defendants advance is precisely the one which the Congress rejected because it had permitted major oil companies to dominate the choice of bidding systems. As stated in the House report (H.R. Rep. 95-590, 95th Cong., 1st Sess., at 103):

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limit competition and restrict the financial capabilities of the successful bidding companies."

(Hearings before the Senate Committee on Commerce, September 8, 1975, on James G. Watt to be a Member of the Federal Power Commission, at 372).

> "It is today's reliance, and tomorrow's dependence on OCS resources that demonstrates the need to reform OCS procedures and to provide new protections.
>
> The committee found that the present law's grant of total discretion to the Secretary led to a situation where the petroleum industry had until recently, as will be discussed later, a too dominate voice in the setting of policy . . . Under the present law's bid system, representatives of the American Gas Association testified the larger energy companies were able to totally dominate leasing."

The Court below has rejected only DOI's position that no non-bonus bidding leasing is required at all, leaving it to administrative discretion to choose "when and how much" net profits bidding should be utilized (Pet. 47a, n. 95). The DOI's present claim of an absolute discretion to refuse to test non-bonus bidding—which Congress hoped would diversify lease acquisitions—nullifies the very reforms which Congress advisedly enacted. The statute does not support defendants' claim of unlimited discretion to reject non-bonus bidding even on an experimental basis. On the contrary, as stated by the Conference Committee in explaining the statute's annual percentage limitations on experimentation: "Bidding systems *other than bonus bidding* . . . are to be utilized in at least 20 percent and not more than 60 percent of the tracts offered for leasing in all OCS areas during each of the next 5 years" (H.Rept. 95-1474, 95th Cong., 2d Sess. at 92, emphasis in original).[13]

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[13] Moreover, the statute provides no discretion at all to the Secretary to conduct leasing in a way that does not "assure receipt of fair market value" (43 U.S.C. § 1344(a)(4)). The plain meaning of the statute's "fair market" value requirement compels at least the testing of the system which appears to yield far higher public returns when it gears returns to actual oil and gas production instead of a gamble on cash-bonus bids—a gamble which few companies can make and few do make under cash-bonus bidding.

* * * *

The lower court's ruling carries out multiple and vital national interests which Congress sought to vindicate by the 1978 amendments. Before the 1978 statute bonus-bid leasing had resulted—as it has since (see Appendix A, *infra*)—in the acquisition of almost all the leases by the major oil companies, in the restriction of oil and gas recovery due to those companies' stockpiling tendency, and in absence of any assurance of fair public returns for resources worth vast billions. The House Committee noted that under the cash bonus bidding system "in order to win a lease, a company must have vast amounts of capital," which may "reduce competition for offshore leases to the major oil companies and reduce the public return for resources" (H.R. Rep. 95-590, 95th Cong., 1st Sess. at 47). As the Congressional reports emphasized (see Pet. 30a-31a, ns. 66, 67), it was hoped that profit share bidding will "increase competition for offshore leases and secure higher returns to the public Treasury," and will also "increase ultimate resource recovery." The statute itself (43 U.S.C. § 1802(2)) identifies the same three objectives. If the testing of profit share bidding would promote only one of them it would be significant enough, but when all three goals are served by experimentation with non-bonus bidding then the strongest public interests support the ruling below.[14]

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[14] Conceding that the opinion below is capable of a quite narrow reading, petitioners nonetheless claim that they may be bedeviled by "considerable further litigation" of an unspecified nature. This is less a challenge to the ruling below than to some imagined future decision, for which the present ruling is given the broadest possible reading. But petitioners did not elect to seek a clarification of the Court of Appeals' opinion or to seek a rehearing from the panel or en banc to resolve alleged "uncertainties," which are more imagined than real. Moreover, petitioners conjure unspecified "delays and disruptions in the orderly development of our OCS oil and gas revenues" (Pet., p. 16). But, as

Moreover, since the Government's petition was filed in this Court it has acknowledged that profit share bidding may in fact advance the Congressional objectives. The proposed profit share bidding regulation published in the Federal Register March 5, 1981 (see *supra*, p. 16) states that "the proposed variable net profit share system would reduce initial cash bonus payments" (p. *15486*), which was exactly what Congress intended. In addition, the regulation states (p. *15487*) that profit share bidding "*is designed to encourage more participation in OCS lease sales by a more diverse range of firms*," and that "*the proposed regulation should lead to increased competition.*" Moreover, the alleged problem of excessively high profit share bids (cf. Pet. p. 12, n. 13) is now seen to arise only in "some situations," and the proposed use of a variable capital recovery factor is expected to discourage speculative bids (p. 15486). Finally, on March 2, 1981 the Department of Interior publicly announced that OCS sale A 66 scheduled for July, 1981 will include specified tracts offered for sale by profit share bidding.

Thus, the Government itself now describes profit share bidding as promising, and likely to further major objectives which Congress identified in requiring a five year period of experimentation. We suggest that under all these circumstances there is no basis for review of a rul-

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the history of this case readily demonstrates, the lower courts have been extremely reluctant to interfere with development of OCS reserves, denying injunctions against specific lease sales in order to give petitioners every opportunity to meet their statutory obligations. Even when it became clear that petitioners were not going to experiment at all with non-cash-bonus systems, despite previous warnings from both the district and appellate courts, the Court of Appeals refused to grant an injunction against three 1980 lease sales, instead directing the promulgation of regulations prior to mid-1981. In light of this demonstrated restraint, it is fanciful to predict that any future lease sales would be delayed if petitioners now implement the experimental program in good faith.

ing which properly carries out the expressed Congressional purpose, and in so doing promotes multiple national interests: diversification of OCS oil and gas acquisitions, recovery of more oil and gas, and better returns from the sale of public resources.

CONCLUSION

It is respectfully urged that the petition should be denied.

Respectfully submitted,

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APPENDICES

APPENDIX A

DETAILS ON LEASE SALES HELD SINCE SEPT. 1978

Sale #	Sale Date	Bids Received Per Tract Offered	Received Bids Per Tract Bid On	% Tracts Receiving Single Bids	Tracts Acquired by Top 20 Producers
65	10/31?78	0.7	1.8	57%	89%
51	12/19/78	2.3	3.4	26%	77%
49	2/28/79	0.7	1.7	52%	68%
48	6?29/79	0.8	2.0	47%	95%
58	7/31/79	2.6	3.6	34%	73%
58A	11/27/79	2.6	3.4	26%	79%
BF	12/11/79	1.3	2.5	28%	96%
42	12/18/79	1.6	2.6	29%	88%
A62	9/30/80	2.6	3.4	29%	76%
55	10/21/80	0.3	1.7	59%	100%
62	11/18/80	3.3	3.6	24%	85%
	Total	1.7	3.0	34%	81%

DETAILS OF FIXED PROFIT SHARE TRACTS OFFERED AT LAST THREE LEASE SALES

Sale #	Sale Date	Received Bids Per Tract Offered	Received Bids Per Tract Bid On	% Tracts Receiving Single Bids	% Tracts Acquired by Top 20 Producers
A62	9/30/80	1.8	2.4	30%	84%
55	10/21/80	0.4	1.8	56%	100%
62	11/18/80	2.7	3.0	35%	74%
	Totals	1.1	2.4	40%	85%

*Source: OCS Statistical Summary 1978-1981, Department of Interior.

APPENDIX B

[SEAL]

UNITED STATES DEPARTMENT
OF THE INTERIOR

OFFICE OF THE SECRETARY
Washington, D.C. 20240

Mar. 30, 1979

Honorable Edmund G. Brown, Jr.
Governor of California
State Capitol
Sacramento, California 95814

Dear Jerry:

One of the purposes of the 1978 amendments of the Outer Continental Shelf (OCS) Lands Act is to protect the interests of affected coastal States. Section 8(g) of the amended statute accomplishes this with regard to Federal proposals to lease within 3 miles of the seaward boundary of a State. It requires that when hydrocarbons occur in pools or fields underlying the boundary between areas of Federal and State jurisdiction, a fair and equitable division be made of revenues generated by a Federal lease in such an area.

In accordance with the terms of the statute, specifically section 8(g)(2), I propose that, for the proposed Sale #48, the interests of the State of California be protected by applying the terms of the enclosed agreement. This agreement is based on conversations with officials of several coastal States, including staff of the California State Lands Commission. It is designed to help assure that, when oil and gas are extracted as a result of a Federal lease from a reservoir underlying the seaward boundary of the State of California, the hydrocarbons and the resultant revenues are fairly and equitably allocated between the Federal and State jurisdictions. This would

be done by unit agreements to which the lessees of both the State and the Federal Government subscribe. In the event unit agreements are not possible or feasible, for whatever reasons, the Federal lessees would be prohibited from conducting operations within a specified distance of the State's boundary. The distance to be used is that which California currently uses in regulating its lessees' operations near lease lines.

I believe that such an agreement not only satisfies the provisions of the statute to protect State interests but, when unit agreements are entered into, also has the added advantages of preventing the construction of unnecessary facilities and realizing the most efficient production of oil and gas.

The statute, in section 8(g)(3) authorizes a maximum of 90 days for you to indicate whether you would accept or reject such an agreement before I can proceed with any leasing of the affected tracts. To help realize the timely production of much needed oil and gas, I request that you respond to this proposed agreement as soon as is practicable but within 60 days if possible.

For Sale #48, proposed for late June 1979, 36 tracts of the 148 remaining in the proposed sale lie within 3 miles of California's seaward boundary. A list of these tracts is enclosed. This list indicates that, on the basis of current information, nine have geologic structures underlying the Federal-State boundary. Of these nine tracts, six have State leases opposite the Federal areas.

While the proposed agreement would apply to any pool or field found to underlie the boundary, this analysis of geologic structures indicates the probable extent of the areas that may contain reservoirs to which the proposed agreement would apply.

I am confident that the State's interests would be protected and oil and gas production would be enhanced if

you were to accept this offered agreement. I hope to hear from you in the near future.

Sincerely,

/s/ [Illegible]
Acting Secretary

Enclosures

UNITED STATES DEPARTMENT OF THE INTERIOR

OFFICE OF THE SECRETARY
Washington, D.C. 20240

[SEAL]

Sept. 4, 1980

Mr. William F. Northrop
Executive Officer
State Lands Commission
1807 13th Street
Sacramento, California 95814

Dear Mr. Northrop:

I am writing to continue the discussions on an agreement for the division of revenues as authorized under section 8(g) of the OCS Lands Act, as amended (the Act).

You stated in your June 14, 1979, letter to Governor Brown, which commented on a proposed agreement by the Department of the Interior and which he forwarded to us, that the information on the geology and other aspects of the areas under discussion should be available prior to the consummation of an 8(g) agreement. An agreement drafted in accordance with section 26 of the Act and tailored to include sharing of information for purposes of section 8(g) has been forwarded to Governor Brown. A copy of the package of materials sent to him is enclosed. When California subscribes to the statutory conditions for sharing geological and geophysical information, I believe it will be possible to arrive expeditiously at an agreement on areas which may be potentially productive.

I believe that the changes you proposed to the agreement suggested by the Department should not prove to be major points of difference between us. I have enclosed draft agreements, one for sale #48 and the other to serve for

future sales that may be held offshore California, which appear to accommodate most of your suggestions and offer compromise positions where necessary.

For sale #48 the changes to your suggestions are as follows:

—The introductory material has been updated to reflect that sale #48 has taken place.

—Paragraph 1 has been edited slightly for clarity and the provision that the State shall use available legal authorities to require a State lessee to enter into a production unit, as well as encourage the lessee to do so.

—Paragraph 2—The distance a producing well can be positioned from the Federal-State boundary, absent a unit agreement, is the subject in this paragraph. The Department believes that 500 feet is more than adequate to prevent drainage of State lands, and California appears to want additional protection in the event 500 feet is not a sufficient distance.

In preparing for sale #48, held on June 29, 1979, stipulation 13 was added to leases. This stipulation, requiring a 500-foot buffer to be observed to prevent draining of State lands absent unitization or approved offset wells, is now a part of the lease contract for the 16 section 8(g) tracts leased. The Governor's rejection of the agreement, offered on March 30, 1979, was received on June 25, 1979. By then it was too late to change the terms and conditions of the lease sale without significant delays.

The paragraph in the proposed agreement for sale #48 recognizes the existing sale #48 stipulation and lease terms. The proposal by California to make the area where drilling may be prohibited of an undetermined size, to be agreed to after a lease is issued, would not be possible for sale #48 tracts where the contract terms have been agreed to. As discussed below, in connection with our proposal for possible future leases off California, the State's desire for additional protection is accommodated.

—Paragraph 3—The Department of the Interior does not object to a lessee entering into a unit agreement with the State as a carried, non-operating interest owner of the unitized lands. However, California would need to assume an equitable share of the costs, as well as of the revenues. This paragraph has been drafted to reflect this balance, and to specify more clearly the meaning of such agreements. The phrase "compensatory agreement" has not been used since the unit agreement would in fact serve that function.

—Paragraph 4—Rates of payment to California are necessarily subject to the terms of unit agreements. This paragraph has been reworded and generally incorporates California's suggestions as to the payment of revenues when production units are established. However, the State suggested requirement for payment on the basis of any lease issued on State lands has not been included. This provision is redundant since the unit agreement provided for would, when entered into, necessarily incorporate relevant provisions of an applicable State lease.
A provision has been added specifying that payment in value or kind is authorized.

—Paragraph 5—This paragraph was removed by California from our original proposed agreement. It is meant to assure that there is no confusion caused by mistaken expectations when offset wells are the procedure used to protect California's interests. This paragraph has been reworded to try to assure that its meaning is clear as to when the conditions for division of revenues have been satisfied.

For future sales, the same agreement is proposed as for sale #48 with a variation in paragraph 2. The better to assure the State that drainage does not result when a unit agreement is not consummated, the Department is prepared to constrain Federal lessees from operating within

750 feet of the State boundary. Again, while the Department considers 500 feet adequate to prevent drainage given the geology off the California coast and the viscosity of hydrocarbons in that part of the Outer Continental Shelf, a distance of up to 750 feet could be agreed to by the Department and the State as being necessary. Such an arrangement would put potential lessees on notice as to the extent of a leasehold on which operations would not be allowed, while satisfying the basic condition of protecting the State's economic interests. All other parts of the agreement are identical to those proposed for sale #48.

I hope that these few changes are satifactory and that we can, in the very near future, complete our discussions and enter into an 8(g) agreement. Your early response to this matter would be most welcome and appreciated.

Sincerely,

LARRY E. MEIEROTTO
Assistant Secretary—Policy, Budget and Administration

Enclosure
cc: Governor Brown

APPENDIX C

[APPEAL]

UNITED STATES DEPARTMENT
OF THE INTERIOR

OFFICE OF THE SECRETARY
Washington, D.C. 20240

Feb. 17, 1981

Honorable Edmund G. Brown, Jr.
Governor of California
Sacramento, California 95814

Dear Governor Brown:

In accordance with the provisions of section 8(g) of the Outer Continental Shelf Lands Act, as amended, I offer you an opportunity to enter into an agreement for the fair and equitable division of revenues from specified Federal leases. This section of the Act requires that you have ninety days to elect whether to enter into such an agreement on the division of lease revenues generated within 3 miles of the State's seaward boundary. I am writing at this time in order to assure that the provisions of the statute will have been met if lease sale #53 does occur in May of this year. While the final decisions on lease sale #53 have not been made, your early reply to this revenue sharing proposal would allow time to make any necessary changes to lease documents prior to the publication of the final Notice of Sale.

The attached proposal is identical to the one sent to Mr. Northrup in September for comment. I understand that subsequent conversations between Interior and State Lands Commission staffs touched on our ongoing attempts to find a basis for agreement with the State of Louisiana for similar revenue distributions. You may choose to await the resolution of those proceedings before entering

into an agreement binding on California. In any event, I would appreciate your views on the attached proposal at your earliest convenience.

Sincerely,

James G. Watt
Secretary

Attachment

AGREEMENT

BETWEEN THE UNITED STATES DEPARTMENT OF THE INTERIOR AND THE STATE OF CALIFORNIA

It is the purpose of this Agreement to set forth a means of implementing Section 8(g)(2) of the Outer Continental Shelf (OCS) Lands Act, as amended, 43 U.S.C. 1337, as to tracts off the coast of California.

With respect to tracts or portions of tracts which may be leased by the Department of the Interior in OCS Lease Sales #53 on May 27, 1981, which lie within three miles of the seaward boundary of the State of California and which contain one or more oil or gas pools or fields underlying both the Outer Continental Shelf and lands subject to the jurisdiction of the State, the following procedures shall be followed by the Secretary of the Interior and the Governor of California.

1. If the State's portion of such a common oil or gas pool or field is under lease by the State, the State shall require its lessee, to the extent permitted by law, to enter into a production unit and unit operating agreement (herein "unit agreement") with the United States' lessee for that oil and gas pool or field, for the fair and equitable allocation of the oil and gas resources extracted and of the associated costs of drilling, completion, and operation. If such requirement is not permitted by law, the State nevertheless will encourage its lessee to enter into such a unit agreement. If the State lessee is so required or, in the absence of legal requirement, is willing to enter into such a unit agreement, the Department of the Interior shall require its lessee of that oil or gas pool or field to enter that unit agreement for the said oil or gas pool or field. The term "oil or gas pool or field" is agreed to

mean a reservoir which contains oil, gas, or hydrocarbon condensates, singly or in combination.

2. If a State lessee cannot be required and is unwilling to enter into a unit agreement, as outlined in Paragraph 1, the Department of the Interior nevertheless shall not allow a well to be operated for production by the Federal lessee with its well bore in the producing intervals closer to the seaward boundary of the State than the distance to be agreed to between the State and the Department, based on analysis of pertinent site-specific data; except that in no event shall the agreed distance be further than 750 feet from the seaward boundary of the State. In the event the State permits production from the lands subject to the jurisdiction of the State from a well for which the bore is closer to the seaward boundary of the State than the distance specified in this Agreement, the Federal lessee shall also be allowed to produce from offset walls in the area of Federal jurisdiction equally close to the boundary.

3. If the portion of a common oil or gas pool or field which is under State jurisdiction is not under State lease when the area under Federal jurisdiction is leased, the Department of the Interior shall require the Federal lessee to enter into a unit agreement with the State, by which the State shall be a carried, non-operating owner with an interest in a part of the production removed by the Federal lessee. The State's equitable share of costs shall be recovered by the Federal lessee only out of the State's equitable share of production or revenues from production. If the State is not legally authorized to enter into a unit agreement, or a unit agreement is not possible for any other reason, including inability of the parties to agree upon its terms within a reasonable time, the Department of the Interior shall require its lessee to conform to the same limitations specified in Paragraph 2. If the State subsequently leases lands containing a common oil or gas pool or field, a unit agreement for produc-

tion shall be entered into. Federal and State lessees shall be required to participate in such an agreement by applicable lease terms, regulations or statutes.

4. When production units are established for pools or fields underlying both the Outer Continental Shelf and lands subject to jurisdiction of the State, it is agreed that revenues shall be paid to the State of California as follows:

(a) Production shall be allocated on the basis prescribed in unit agreements and,

(b) Revenues payable to the State of California for production allocated to State lands shall be determined by the application to such production of a rate of payment specified by the terms of a unit agreement entered into in accordance with the provisions of this Agreement.

(c) The manner of payments, whether in value or in kind, shall be determined by the terms of applicable unit agreements.

A unit agreement pursuant to this Agreement shall be the basis for assuring fair and equitable allocation of production, costs and revenues when drainage of State lands occurs from Federal lessee activities.

5. When no unit agreement has been consummated for an oil or gas pool or field underlying both the Outer Continental Shelf and lands subject to State jurisdiction, it is agreed that the constraints imposed on Federal lessees by the Federal Government as to distances of well bores from the seaward boundary of the State, in accordance with paragraphs 2 and 3 above, protects the State of California from any loss of revenue or production as a result of Federal leasing and, it is further agreed, on

division of revenues generated from such leasing is appropriate.

James G. Watt Secretary of the Interior Feb. 17, 1981	_____ Governor of California
_____ Date	_____ Date